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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)
)
Implementation of the) CC Docket
Pay Telephone Reclassification) No. 96-128
and Compensation Provisions of the)
Telecommunications Act of 1996)

AT&T's Opposition to and Comments on Petitions for
Reconsideration of the Second Report and Order

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Pursuant to Section 1.429 of the Commission's Rules and the Public Notice published December 23, 1997 (62 Fed. Reg. 67072), AT&T Corp. ("AT&T") submits the following opposition to, and comments upon, other parties' petitions for reconsideration of the Second Report and Order in this proceeding.¹

Summary and Introduction

Except for the PSPs' predictable and insupportable demands for ever-higher compensation, the petitions all start from a common premise: the per-call compensation rate

¹ Petitions for reconsideration were filed by American Alpha Dispatch Services, et al. ("American Alpha"); American Public Communications Council ("APCC"); Consumer-Business Coalition for Fair Payphone-800 Fees ("Consumer-Business Coalition"); Direct Marketing Association ("DMA"); Mobile Telecommunications Technologies Corp. ("M-Tel"); PageMart Wireless, Inc. ("PageMart"); Paging Network, Inc. ("PageNet"); Peoples Telephone Company, Inc. ("Peoples"); Source One Wireless II, LLC ("Source One"); and the RBOC/GTE/SNET Payphone Coalition.

developed in the Second Report and Order is too high and is not consistent with the statutory mandate of "fair" compensation.² AT&T opposes a number of the specific requests for relief set forth in some of those petitions, because they are either impracticable or based on erroneous premises. However, AT&T agrees with petitioners that the Commission should either develop a truly cost-based approach to payphone compensation -- which would clearly be "fair" to all -- or adopt a true market-based approach in which payphone users are required to pay directly for the costs imposed by their decision to use a particular payphone.

I. The Current Compensation Rate Creates a Windfall for PSPs and Should Be Reduced to a True Cost-Based Rate.

The Consumer-Business Coalition represents a broad cross-section of interests, from the Consumer Federation of America and the International Communications Association, to individual business subscribers, to non-profit organizations such as AAA and the National Network to End Domestic Violence. The Coalition's petition (p. 1) correctly states that the 28.4 cent rate established in the Second Report and Order "provide[s] payphone owners with an unfair windfall [and] it has a severe and unwarranted impact on millions of

² E.g., Consumer-Business Coalition, p. 2; PageNet, p. 5; DMA, p. 4 (current compensation rate threatens many public service and business applications of toll free services).

consumer and business users of 800 service" (emphasis in original). Further, the Coalition's petition (p. 2) recognizes that "[g]ranteeing payphone owners a windfall profit at the expense of long distance carriers and 800 service subscribers is entirely inconsistent with the fair compensation standard" of Section 276. AT&T supports the Consumer-Business Coalition's call for the Commission to correct on reconsideration the critical deficiencies in the Second Report and Order and to adopt a true cost-based method for calculating a per-call compensation rate that is fair to all.³

Based on their real-world experience, the members of the Consumer-Business Coalition (p. 3) confirm what AT&T has been saying throughout this proceeding, i.e., that "callers have virtually no choice in payphones at any particular location and there is no reason to believe that the marketplace will undergo a complete metamorphosis." Thus, the Coalition (p. 4) properly criticizes the "market" approach adopted in the payphone orders, because those orders "failed to take into account that the payphone market

³ Contrary to APCC's claim (p. 7), however, the Commission cannot properly base a "bottoms-up" cost-based compensation rate solely on the costs of independent payphone providers. A true cost-based approach must consider the costs of all PSPs, including the LECs, who represent about 75% of the industry.

is not yet competitive on a point of sale basis and may never be."⁴

The Coalition members (id.) also recognize that "even if point of sale competition were ultimately to exist, most callers of 800 numbers [which represent a large majority of compensable calls] have no incentive to seek out the least expensive payphone alternative because they do not pay for the call."⁵ This absence of market incentives fully supports the Coalition's view (id.) that payphone compensation should be based on PSPs' forward-looking costs, at least until there is widespread point of sale competition in the payphone market.⁶

The Consumer-Business Coalition's petition (pp. 6-14) also shows the significant marketplace impacts of the current excessive payphone compensation rate. Some business 800 subscribers' rates will rise by millions of dollars per

⁴ Thus, even if the RBOC/GTE SNET Coalition (p. 2) were correct that "any price set by a free an open market, by definition the 'fair' rate," no such market exists in this case.

⁵ See also id., p. 4.

⁶ The importance of widespread competition at the point of purchase is demonstrated by the affidavit of Greg F. Atkinson ("Atkinson Aff.") (pp. 3-4), who explains that truckers have no practical alternatives to payphones at truck stops and public rest areas; that such phones are in "virtual constant demand;" and that there is no choice of payphone suppliers at such locations. See also Affidavit of Eugene R. Dupre' ("Dupre' Aff.") (pp. 3-4).

year, and in some cases the increases will have a double-digit effect on those subscribers' net income. As DMA (p. 4) notes, "the Commission must weigh the concerns not only of PSPs, but also the carriers that pay them, and the impact . . . market-based or other pre-established compensation rates will have on the public in general."⁷ Application of a true cost-based rate would fairly consider the interests of all these parties.

This is especially important because, as the Coalition (p. 12) recognizes, the possibility of blocking -- the key rationale supporting the current market-based approach to compensation⁸ -- does not provide a significant counterbalance to PSPs' market power: "This alleged bargaining chip [of blocking] is insignificant, . . . because many IXCs and 800 number subscribers rely on the fact that their services may be accessed from all payphones".⁹ Thus, a market-based approach to payphone compensation simply cannot result in a fair compensation

⁷ See also PageNet, pp. 7-8 (fairness of payphone compensation levels "must be measured by more than just whether it enriches PSPs" and must include a consideration of fairness "to those parties that ultimately will be required to bear the compensation").

⁸ See RBOC/GTE/SNET Coalition, p. 7.

⁹ Emphasis in original. See also Atkinson Aff., p. 4 (because truckstops use a single payphone provider, a trucking company cannot block calls from any specific payphone or PSP); Dupre' Aff., p. 4 (same).

rate under actual market conditions.¹⁰ Moreover, the Affidavit of David M. Rich of American Airlines (p. 3) notes the substantial potential for fraud that an 800 subscriber could face from even a single telephone, and American Alpha (pp. 3-4) provides real evidence that such fraud is beginning to occur. Adoption of a cost-based compensation system would also reduce the economic incentives for such conduct.

The Consumer-Business Coalition (pp., 17-18) also correctly states that the decision to adopt a "market surrogate derived from a market that enjoys virtually no competition . . . represents a radical departure from prior Commission approaches to encouraging competition in non-competitive marketplaces." Especially given the fact that "there is no evidence that payphone competition is widespread on a point of sale basis" (p. 19, emphasis added)¹¹ the Coalition (p. 22) recognizes that the payphone

¹⁰ It is also critical to note that the current rules unfairly subject non-profit Coalition members such as AAA and the National Network to End Domestic Violence to significant costs. As the latter states, "blocking calls [relating to domestic violence] from some or all payphones is not an option" (Declaration of Donna F. Edwards, p. 1). See also DMA, p. 4 ("it would serve no one to discontinue (or block) a crisis line offering counseling to victims of abuse, to runaways, to the depressed or suicidal, to the hungry or homeless").

¹¹ Even the Second Report and Order recognizes that the payphone market is not yet competitive. See Consumer-Business Coalition, p. 18.

orders enable PSPs "to set coin call prices at levels far above the cost of providing service. To then use that price as a basis for developing the coinless rate -- which must be paid by captive 800 service subscribers -- makes no sense."¹²

Therefore, AT&T fully supports the following conclusion of the Coalition (p. 21), which shows that there is no basis to rely on a deregulated local coin rate to calculate per-call compensation:

"Without point of sale competition, the number of payphones deployed or the number of new entrants in the market has no relevance to determining what the appropriate rate should be for coinless calls. . . . In relying on market forces to set rates under these circumstances, the Commission has effectively enhanced the ability of incumbent payphone providers to use their revenues to protect their market share, as well as discourage potential competitors from entering the marketplace."

AT&T also fully concurs with the Coalition's view that there may never be effective competition for 800 subscriber calls from payphones. As the Coalition states (p. 21), "even if competition on a location-by-location basis did develop, the 'market' will not necessarily be able to set a fair rate for subscriber 800 calls . . . because callers to toll free numbers are not footing the bill for the call [and] they generally have no reason to seek out the lowest

¹² See also M-Tel, pp. 6-8.

cost payphone at any particular place of business." In the absence of significant market incentives for callers to use the most economically efficient means of using toll-free services, there is simply no substitute for a true cost-based approach to payphone compensation.

II. A Flat-Rated Cost-Based Compensation Rate Is Fair to All Interested Parties; Thus There Should Be No Special Treatment for Specific Categories of Calls.

By adopting a reasoned cost-based approach to per-call compensation, the Commission can balance the needs of all interested parties, including PSPs, carriers and consumers. Thus, if the Commission adopts a proper cost-based approach, it should not grant any of the petitions that seek "special treatment" for specific categories of compensable calls.¹³ In particular, the Commission should reject suggestions that different types of calls (e.g., calls to paging companies) should be charged a lower rate, or that the compensation amount should be based on the duration of a call.

PSPs' costs are incurred on a per-call, not a per-minute, basis. More important, payphones perform exactly the same functions for each and every compensable non-coin call, and there is no basis to distinguish among different call types based on their payphone-associated costs. Thus, contrary to PageNet's claim (p. 5), it is not unfair to

¹³ E.g., DMA, p. 2; Source One, p. 5.

apply a flat, cost-based compensation rate to all compensable calls.¹⁴

PageMart's claim is built on a faulty premise. Contrary to its assertion, PSPs do not provide a full service to a caller who makes a compensable call. Rather, PSPs only provide callers with the use of a telephone set and a line to a LEC central office that enables them to make calls that are completed using network facilities owned or leased by another company (a carrier). Moreover, none of the PSP costs associated with payphone use are time-sensitive.¹⁵ Thus, PageMart (p. 4) is wrong that it "is axiomatic that the true cost of providing a payphone call varies based on the duration of the call,"¹⁶ because the statutorily-mandated compensation for payphone use is not

¹⁴ See also PageMart, p. 5 (shorter calls would subsidize longer calls). Contrary to PageMart's claim (p. 12), in a cost-based compensation system, it is irrelevant that payphones are used to provide different services with different usage and cost characteristics. AT&T agrees, however, that such issues could be relevant in a market-based compensation system.

¹⁵ None of the costs reviewed in the Second Report and Order was related to the duration of a call. In fact, carriers and PSPs agreed that the only possible time-sensitive cost (i.e., the cost for network use in completing a local call) was properly excluded from consideration because it is only incurred in connection with local coin calls.

¹⁶ See also PageNet, p. 15 ("[i]n the end PSPs are selling time on the phone, not calls" (emphasis in original)).

the same as the tariffed or other charge that a carrier bills for completing a phone call.¹⁷

There is also no technological infrastructure that would enable carriers to track and pay per-call compensation for toll-free calls based on the duration of a call. Even when Flex ANI capability is fully deployed, carriers will only know that a call is originating from a payphone. To AT&T's knowledge, no carrier (including AT&T) has an infrastructure in place that would allow it to track, calculate and pay to PSPs compensation based on call duration.

The toll-free subscriber petitioners who request this radical change in the compensation tracking systems¹⁸ appear to confuse carrier systems for billing calls to end user customers with the separate tracking systems that have been built to comply with the Commission's payphone orders. The mere fact that a carrier bills its customers based on call duration does not demonstrate that it can also track and pay payphone compensation to other entities (PSPs) on the same basis. Moreover, petitioners who seek this change offer no rationale why carriers should have to incur additional

¹⁷ A more appropriate analogy in these circumstances is the charge that hotels sometimes assess on guests for placing telephone calls from their room telephones, not the charges assessed by the carriers that complete such calls.

¹⁸ See PageMart, p. 5; PageNet, pp. 15-16.

expense to track per-call compensation in a manner never before seriously considered by the Commission.¹⁹

The Commission should also reject requests to adopt a multi-tiered system of 8XX codes to implement a "modified caller pays" system for payphone compensation.²⁰ First, any such system is speculative and does not yet exist. Thus, it could not be implemented at this time. Just as important, the proposal does not identify how carriers would be able to exclude calls to such codes from their current compensation tracking systems, so they would not compensate PSPs twice for calls to the proposed 8XX codes.

III. The Commission Should Reject PSPs' Pleas For Even Higher Compensation.

Predictably, the PSP petitioners seek an even higher compensation rate. All of the PSPs' requests should be denied.²¹

¹⁹ PageNet's reference (p. 8) to the Commission's six year-old NPRM in CC Docket No. 91-35 does not support its position. As PageNet (p. 9) admits, "the Commission abandoned the idea" of basing dial-around compensation on call duration because it was impracticable. PageNet's lack of awareness of the technical difficulties cited above does not alter the fact that the same technical problems that existed in 1991 and 1992 continue today.

²⁰ PageMart, pp. 8; American Alpha, pp. 5-6.

²¹ As a preliminary matter, the RBOC/GTE/SNET Coalition's continued references to differing demand elasticities (pp. 2-8) ignore AT&T's proof on remand that the demand for coin and coinless calls are not related. As AT&T showed, the use of "Ramsey pricing" principles here would guarantee PSPs a monopoly price (see AT&T Reply, CC Docket No. 96-128, dated

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A. The Costs of Coin Functionality Were Properly Deducted.

The Second Report and Order (¶ 53) correctly identified that the equipment cost associated with the handling of coins is, on average, \$.031 per call. Nevertheless, the PSP petitioners argue that the Commission should not have deducted the cost of the payphone coin mechanism and coin-related features in calculating the rate for per-call compensation.²² Once again, the PSPs fail (or refuse) to grasp the simple concept that coinless calls do not use any coin-related functions and thus should not be required to support the costs of such functions -- especially since PSPs are now free to recover all of those costs through deregulated coin rates.²³ Any other result would not, in the words of the statute, be "fair" to carriers and to the

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December 9, 1997, n.14). Moreover, contrary to the RBOC/GTE SNET Coalition's claim (p. 3) an avoided cost methodology that subtracts costs from prices is economically irrational (id., p. 21). In addition, Peoples' (p. 3) reference to the avoided cost pricing methodology in Section 252(d)(3) is particularly inapt, because carriers do not "resell" any retail service offered by PSPs. Rather, the existing rules require carriers to pay for the use of a payphone as an input into their finished product (a completed call) (id., Affidavit of Frederick Warren-Boulton, p. 2).

²² APCC, pp. 9-14; Peoples, pp. 4-6; RBOC/GTE/SNET Coalition, pp. 8-15.

²³ See AT&T Reply, pp. 7-8. See also Second Report and Order, ¶ 52 ("costs directly associated with the coin mechanism should be attributed to coin traffic").

consumers who must ultimately bear the costs of payphone compensation.²⁴

Moreover, contrary to the RBOC/GTE/SNET Coalition's claims,²⁵ the Second Report and Order accurately accounts for the coin-related costs of payphone equipment. For example, the report of the coalition's witness Mr. Geppert (p. 6) states that "it is [his] understanding that the 11A payphone is not comparable to the standard dumb or smart coin set primarily because the 11A payphone housing is made of less durable materials that are susceptible to outdoor elements." This statement misses the point. AT&T never argued that the 11A is "comparable" to a coin set; rather, AT&T showed that the costs of the 11A are representative of the costs of the components necessary to provide service for coinless calls. Thus, an 11A set is essentially what would be left if one were to take out all of the coin-related features from a coin phone and did not have to protect the cash in the box from theft.²⁶ Accordingly, the Commission's

²⁴ Contrary to the PSPs' apparent claims on reconsideration (e.g., APCC, p. 12), PSPs admitted on remand that coin calls (not coinless calls) drive the economics of payphone placement (see AT&T Reply, pp. 8-9). Moreover, once a PSP decides to place a coin phone, there are absolutely no "added" costs relating to coinless calls (id.).

²⁵ RBOC/GTE/SNET Coalition, Andersen Report, pp. 12-13.

²⁶ Mr. Geppert is also wrong in claiming that the 11A set is not outdoor compatible. AT&T has successfully operated 11A sets outdoors for over 10 years. In fact, AT&T's

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decision to use the costs of an 11A set was fully consistent with its efforts to identify coin-only costs.

B. Compensation Collection Costs

APCC (pp. 14-15), Peoples (pp. 6-8) and the RBOC/GTE/SNET Coalition (pp. 16-18) all ask the Commission to increase the per-call compensation rate by adding amounts associated with bad debt and the per-call compensation collection process. These claims should be rejected.

APCC claims that the total costs associated with bad debt and collection are approximately 4 cents per call.²⁷

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experience indicates less trouble with outdoor 11A's than outdoor coin phones, because there is no vandalism associated with coin-in-the box and there are fewer frustrated customers who damage phones because their coins were not returned. Thus, Mr. Geppert's effort (pp. 7-8) to calculate the average "cost of a coinless set with the same durability of a dumb coin set, but without the coin mechanism" is irrelevant. Further, AT&T's experience indicates that the useful life of an 11A coinless phone is no less than the useful life of a coin phone. Indeed, the life of an 11A could be longer, because it is subject to less abuse than coin phones. Thus, Mr. Geppert's adjustments to reduce the useful life of the 11A from 10 years to 7 years are also invalid.

²⁷ The RBOC/GTE/SNET Coalition's petition adds no information on these issues and simply incorporates the APCC's conclusions, because the coalition members -- who own the majority of all payphones in the country -- have had virtually no experience with collecting payphone compensation. It should also be noted that the coalition's poetic reference (p. 16) to possible defaults by resellers is more than offset by its admission that the Commission's rules require facilities-based carriers to make the compensation payments to PSPs on behalf of the carriers that resell their services.

Peoples states that 1.4 cents/call should be added for "bad debt expense." Peoples' claim, however, is based entirely on data that reflect its bad debt experience during the first nine months of 1997. This analysis must be disregarded, because the industry experience during the time period it references is unique. All carrier compensation duties for this period were the subject of intense litigation during that period, and the D.C. Circuit ultimately issued an order clarifying that it had vacated the Commission's rules on interim compensation. Moreover, the Commission has not yet acted on remand to establish rules for that period. Thus, Peoples' claims are based solely on activity during a period in which there were no legally sustainable rules, and they provide no basis for a prediction of future conduct.

APCC's petition (p. 14), in contrast, is intended to lead a reader to believe that the estimated 8% of per-call compensation revenue not collected was due exclusively to LEC non-compliance and IXC recalcitrance. This is not true. In fact, AT&T previously showed that the IPPs themselves are principally responsible for the problems APCC identifies.

And in any event, problems caused by LEC actions should not be charged against carriers.²⁸

The documentation APCC supplied with its petition contains a summary of outstanding ANIs that were disputed. Omitted, however, is the fact that the IPPs created the majority of these disputes themselves because they either (i) submitted lines for compensation that were not tariffed as payphone lines (and thereby not eligible for compensation); (ii) had multiple IPPs submitting the same ANI for payment (most likely as a result of the many payphones that have changed ownership during the evolution of this business); or (iii) submitted inadequate or flawed proof of ownership.²⁹ And whatever the merits of APCC's claims regarding performance under the old dial-around compensation regime, APCC ignores the fact that the Commission's new verification rules eliminate many of the bases for prior disputes.³⁰ Thus, past experience is not an accurate indicator of future performance in these matters.

²⁸ Although LECs must cooperate with PSPs to provide verification/certification, they sometimes were unable to identify IPP lines as payphone lines, because a number of IPPs used ordinary 1MB-type business lines for their payphones.

²⁹ See AT&T Reply Comments, CC Docket No. 96-128, dated September 9, 1997 ("AT&T Reply"), Affidavit of David Robinson ("Robinson Reply Aff."), pp. 10-11.

³⁰ See id. Under the prior regime, IXCs requested bill verification to resolve disputes. In contrast, the

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PSPs' suggestions that the Commission should add to the compensation rate to cover PSP costs to administer the per-call collection process are equally baseless. At a collection cost of 2 cents per call, a typical RBOC/GTE/SNET Coalition member with 200,000 phones and an average of 152 calls per month per payphone would have to have approximately 120 people working to collect per call compensation, assuming it used full time employees at a rate of \$60,000/year. That would represent about 15% of the entire workforce at BellSouth's payphone subsidiary, and is clearly excessive.³¹ The PSPs' arguments also ignore that carriers have had to incur (and will in the future incur) millions of dollars in costs to implement the currently-mandated tracking and payment requirements. PSPs should not

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Commission's new rules for the per-call compensation process will virtually eliminate ongoing disputes on a specific ANI. Once a carrier has paid compensation to a PSP on a particular ANI, the carrier must continue to make payments to that PSP until notified by the LEC that the line has been disconnected. In this regard, the APCC data indicate that about 20% (49,150 of 241,682) of disputes were resolved under the old system. However, AT&T's experience indicates a much higher percentage of disputes were resolved. Working with the Cincinnati Bell ("CBT") clearinghouse, AT&T determined that CBT resolved 66% of disputes on behalf of AT&T between 2Q95 and 3Q96. This resolution rate would have been even higher if the new "pay-till-you-hear-otherwise" rules had been in effect during that period.

³¹ See also Robinson Reply Aff., p. 10 (similar analysis based on costs presented by one PSP (CCI) on remand).

be permitted to seek recovery of any of their so-called collection costs from carriers unless carriers are also permitted to recover their implementation costs from PSPs.³²

IV. If The Commission Persists In Applying A Market-Based Compensation System, It Should Adopt A Caller-Pays Model.

As noted above, and consistently throughout AT&T's comments in this proceeding, AT&T supports a true "bottom up" cost-based method for calculating the rate for payphone compensation that considers the costs of all PSPs -- especially LECs, who own the vast majority of payphones. If, however, the Commission should decide not to adopt such a fair and rational system, AT&T would support the requests of several petitioners that the Commission reconsider adoption of the caller pays mechanism for per-call compensation.³³

The Court of Appeals' entire analysis regarding the use of a market-based approach centers on the relationship

³² AT&T Reply, p. 29. APCC's (pp. 16-17) and the RBOC/GTE/SNET Coalition's (pp. 18-20) claims regarding the costs assigned to Flex ANI are rebutted in AT&T's Petition for Reconsideration (pp. 19-20). In sum, the aggregate costs for Flex ANI now appear to be so low for equal access offices (the only offices which should be required to provide Flex ANI), they should be ignored. AT&T's Petition for Reconsideration (pp. 18-19) also shows that, contrary to the RBOC/GTE/SNET Coalition's claim (pp. 15-16) that the Second Report and Order significantly understated, rather than overstated, PSPs' line savings on coinless calls.

³³ PageMart, pp. 6-8; PageNet, p. 3; Source One, pp. 5-8.

between PSPs and the persons who use their payphones. Even APCC (n.6), one of the staunchest supporters of the market-based approach, acknowledges that the Court of Appeals only "specifically affirmed the Commission's reliance on market forces to determine fair compensation for local coin calls" (emphasis added; citation omitted). The only parties involved in the provision of local coin calls are the PSP and the caller, and, as PageNet (p. 3) correctly states "it is the caller -- and only the caller -- that can effectively discipline the compensation rates charged by PSPs." Moreover, as Source One (p. 7) states, only the calling party pays method "provides economic incentive for the caller . . . to choose the lowest cost service [because] under the present carrier-pays mechanism, the party placing the call is not concerned about the [compensation] rate . . . [and] there is no incentive for the PSP to consider market demands" in establishing a compensation rate.³⁴

In sum, the market relationships and dynamics which underlie a market-based compensation approach rest upon the ability of a caller -- not a carrier or 800 subscriber -- to impose market discipline on PSPs by either agreeing or refusing to pay the PSPs' price for the use of the phone at the time a call is made. Thus, AT&T agrees that the only

³⁴ See also Consumer-Business Coalition, p. 21.

efficient and fair method to implement a market-based compensation system would be through the caller pays mechanism.

Conclusion

For the reasons set forth above, the Commission should (i) recognize that the compensation rate in the Second Report and Order is unfair and excessive; (ii) adopt a true bottom-up cost-based compensation rate for per-call compensation that is based on the costs of all PSPs, especially LECs, and (iii) apply that cost-based rate to all compensable non-coin calls. In all events, the Commission should reject the PSPs' baseless requests for even higher per-call compensation.

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January 7, 1998

Certificate of Service

I, Rena Martens, do hereby certify that on this 7th day of January, 1998, a copy of the foregoing "AT&T's Opposition to and Comments on Petitions for Reconsideration of the Second Report and Order" was served by U.S. first class mail, postage prepaid, to the parties listed below.

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